

**PREPARED REBUTTAL TESTIMONY
OF LENA GEORGIEV
ON BEHALF OF
CHARMAR WATER COMPANY
CHERRY HILL WATER COMPANY
CLARENDON WATER COMPANY
FERSON CREEK UTILITIES COMPANY
HARBOR RIDGE UTILITIES, INC.
KILLARNEY WATER COMPANY**

1 **Q. Please state your name, title, business address and reason for your testimony.**

2 A. My name is Lena Georgiev. I am a Regulatory Manager for Utilities, Inc. (“UT”) and its
3 subsidiaries. My business address is 2335 Sanders Road, Northbrook, Illinois 60062. I am
4 providing rebuttal testimony on behalf of Charmar Water Company, Cherry Hill Water
5 Company, Clarendon Water Company, Ferson Creek Utilities Company, Harbor Ridge
6 Utilities, Inc., and Killarney Water Company (“Companies”) in response to testimony
7 provided by the Illinois Commerce Commission’s (“ICC”) Staff and Attorney General’s
8 witnesses.

9 **Q. Ms. Georgiev, have you previously filed testimony in this proceeding?**

10 A. Yes, I have.

11 **Q. What is the purpose of your rebuttal testimony?**

12 A. The purpose of my rebuttal testimony is to respond the various recommendations and
13 adjustments proposed in the direct testimony of the Illinois Commerce Commission Staff
14 and Attorney General witnesses.

15

16 INTEREST SYNCHRONIZATION

17 **Q. Do you agree with Staff’s proposed adjustment to interest and cost of debt?**

1 A. Yes, I do. Staff included both long and short term debt and the appropriate cost rates as
2 shown on ICC Staff Exhibit No. 1.0, Schedule 1.06. My calculation is contained in Exhibit
3 No. 3.0, Schedule 3.1 W & S for each company.

4
5 GROSS REVENUE CONVERSION FACTOR

6 **Q. Do you agree with Staff's Gross Revenue Conversion Factor?**

7 A. Yes, I do. The Companies' gross revenue conversion factors are embedded in my
8 supporting work papers and exhibits.

9
10 WORKING CAPITAL

11 **Q. Do you agree with Staff's and the Attorney General's adjustments to the Companies'**
12 **cash working capital?**

13 A. I agree with Staff's adjustment to remove property taxes from cash working capital and that
14 adjustment is reflected in my schedules. However, I do not agree with the Attorney
15 General's proposal to eliminate cash working capital. First, Mr. Brosch states on page 20
16 of his testimony that "... a real utility...typically has many input resource costs that are
17 incurred to provide service, including employee labor, employee benefits, purchased
18 materials, taxes and interest expense." It appears that one of Mr. Brosch's reasons for
19 excluding cash working capital is that a utility may have one output but many input
20 resources that are incurred and ultimately included in cash working capital when utilizing
21 the one-eight method. Mr. Brosch lists these input resources and thereby linking them to
22 cash working capital. However, Mr. Brosch would have the Commission believe that taxes

1 and interest expense are included in cash working capital when using the one-eight method.

2 However, it is clear from the Company's schedules that assumption is not correct.

3 **Q. Have the Companies excluded taxes and interest when calculating cash working**
 4 **capital?**

5 A. Yes, I removed taxes and interest when calculating cash working capital. Only operating
 6 and maintenance expense as well as taxes other than income are included in the one-eighth
 7 method of calculating the level of cash working capital.

8 **Q. What are other reasons that you disagree with the Attorney General's adjustment to**
 9 **remove cash working capital?**

10 Y. Yes. Mr. Brosch recognizes on page 20, lines 431 – 434 that “it is often more expensive to
 11 conduct a lead-lag study than is justified by the value of the rate base allowance that
 12 results.” Mr. Brosch is one hundred percent accurate with this assumption. The cost of
 13 engaging consulting firm that specializes in preparing lead-lag studies would be
 14 approximately \$10,000 per company. This cost represents only external costs and does not
 15 address any additional internal time and/or expense that necessarily would be incurred.
 16 Below is a table comparing the cost per company to conduct a lead-lag study vs. the cash
 17 working capital requested in this rate case:

	Cash Working Capital	Cost of Lead-lag Study
Ferson Creek	9,364	10,000
Harbor Ridge	7,775	10,000
Clarendon	14,926	10,000
Cherry Hill	9,088	10,000
Charmar	5,175	10,000
Killarney	11,135	10,000

1 The cost of a lead-lag study would increase rate case expense, and customers' rates because
2 these costs would ultimately be borne by the ratepayers. It is not reasonable to expect
3 small utilities to expend the resources necessary to prepare a fully developed lead-lag
4 study. For example, the above working capital allowance that Staff has proposed for
5 Ferson Creek would generate approximately \$706 in annual revenue (grossed up for tax).
6 Assuming the cost of the lead-lag study is amortized over five years, which is consistent
7 with the rate case expense amortization period then the costs to the customers would be
8 \$2,000 per year, which is almost three times greater than the revenue requirement proposed
9 by the Company. Clearly, the relatively high cost of the lead-lag study far outweighs the
10 benefit of any perceived accuracy that the study would provide. The 45 day standard
11 formula method (one-eighth approach) provides a reasonable and cost-effective means to
12 estimate a utility's very real investment requirement for cash to bridge the gap between the
13 time expenditures are required to provide services and the time collections are received for
14 such service. It would not be a sound economic decision for the Companies to prepare a
15 fully developed lead-lag study and to charge the ratepayers for the cost of preparing the
16 study. The Attorney General asked the Companies what has been done to reduce rate case
17 expense. Implicit in the question is an interest in keeping rate case expense as low as
18 possible, which is inconsistent with Mr. Brosch's desire that the Companies and their
19 customers bear the costs for a lead-lag study. Mr. Brosch's approach penalizes small
20 utilities, such as the six utilities in this case, because they have sought to lessen rate case
21 expense by not paying for the costly preparation of a lead-lag study. The Companies
22 proposed one-eighth of the annual cash operations and maintenance expense allowance
23 provides a reasonable method for allowing these smaller utilities a modest rate base

allowance for cash working capital without requiring them to incur substantial costs to conduct a full lead-lag study.

Q. Is the one-eighth method an accepted method for calculating cash working capital requirements?

A. Yes., In his publication, *The Regulation of Public Utilities* (1993 Ed.) at 348, Dr. Phillips elaborates on working capital allowance. Dr. Phillips states that cash working capital may be determined in three basic ways:

- 1) A detailed lead/lag study, which measures the amount of time before expenses must be paid (expense lead) and compares it with the amount of time before revenues are received (revenue lag).
- 2) A formula approach (**developed to avoid a costly lead/lag study**), which commonly uses one-eighth of a utility's annual operating and maintenance expense, excluding fuel and purchased power. The factor of one-eight equates to a forty-five-day lag between the rendering of the service by a utility and payment by the customer. (emphasis added)
- 3) The balance sheet method, representing the difference between a utility's current assets and current liabilities.

In addition the Commission has approved cash working capital allowance for similarly situated small sized water and wastewater companies based on the one-eighth method in the following cases:

Apple Canyon Utility Company	09-0548
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Lake Wildwood Utilities Corporation	09-0549
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Northern Hills Water and Sewer Company 10-0298

Galena Territory Utilities 10-0280

Whispering Hills Water Company 10-0110

Consolidated Dockets 03-0398/0399/0400/0401/0402:

Cedar Bluff Utilities, Inc.

Apple Canyon Utility Company

Charmar Water Utility Company

Cherry Hill Water Company

Northern Hills Water & Sewer Company

LEGAL EXPENSE NORMALIZATION ADJUSTMENT (Charmar only)

Q. Do you agree with Staff's adjustment to normalize legal expense for Charmar?

A. For the purposes of resolving the current rate case, the Companies will not oppose the adjustment.

OUTSTANDING ISSUE

Q. Please respond to the outstanding issue related to Home Serve USA.

A. The response to DLH-13 has been provided. The revenues collected and booked by the parent company, Utilities Inc., are non-utility in nature. Those non-utility revenues are not included in the Companies' revenue requirement for rate making purposes. No expenses associated with the activity have been included in the Companies revenue requirements.

UTILITY PLANT – ADJUSTMENTS TO RETIRE PLANT

1 **Q. Do you agree with Staff's adjustments to retire plant?**

2 A. Yes, I do. The Companies agree to book the recommended retirement entries within 60
3 days of the final order.

4 **Q. Do you agree with Staff's adjustments to accumulated depreciation, accumulated**
5 **deferred income taxes and depreciation expense related to these retirements?**

6 A. Yes, I do. In my rebuttal exhibits, accumulated depreciation has been adjusted to reflect
7 adjustments calculated in the Companies' response to Staff data request TEE 8.01 and 8.02.

8

9 UTILITY PLANT ADJUSTMENTS (Charmar only)

10 **Q. Does Charmar oppose Staff's adjustments related to the Charmar plant?**

11 A. In part, I agree. I agree with the adjustment to accumulated depreciation related to the
12 Company's error. Charmar will not oppose the the adjustment to the amortization period.
13 However, I do not agree with the removal of the easements and legal fees from the plant
14 balance. I recommend reclassifying these fees to the Land and Land Rights Account. The
15 costs were prudently incurred in association with obtaining EPA approval to operate an
16 above ground storage tank, which is required by the EPA. The easements were part of
17 establishing ownership of the asset and at the time, the costs were prudently incurred. The
18 Uniform System of Accounts ("USOA") Accounting Instruction 24 clearly states that
19 easements are included in land and land rights:

20

21 The accounts for land and land rights include the cost of land owned in fee by the
22 utility and rights, interests, and privileges held by the utility in land owned by
23 others, such as leaseholds, **easements**, water and water power rights, diversion
24 rights, submersion rights, rights of way, and other like interests in land. Do not
25 include in the accounts for land, land rights, and rights of way costs incurred in
26 connection with first clearing and grading of land and rights of way and the
27 damage costs associated with the construction and installation of plant. Such

1 costs shall be included in the appropriate plant accounts directly benefited.
2 (emphasis added)
3

4 I have made the appropriate adjustment in my exhibits to remove accumulated depreciation
5 and depreciation expense related to those expenditures.

6 **Q. Do you agree with Staff's recommendation to reduce the extraordinary property**
7 **losses by the estimated salvage and tax savings?**

8 A. Yes, in part, I agree. I agree with Staff's recommendation to reduce the losses by the
9 estimated salvage value. The most recent depreciation rates including net salvage values
10 were established during the Charmar 2004 rate case in Docket No. 03-0400. I have
11 adjusted the depreciation rates and net salvage values for the additions related to the
12 extraordinary retirement from 2005 to 2010. These adjustments are included in Exhibit 3.0
13 workpaper. Prior to 2005, the depreciation rates were 1.50% and salvage values were not
14 yet established.

15 I disagree with Staff's proposal to include a tax savings adjustment in the retirement
16 calculation. The tax savings are already incorporated through the retirement of the plant
17 itself. The tax liability of the Company is already decreased by including the extraordinary
18 depreciation in the test year and to net taxable income figures going forward.
19

20 UTILITY PLANT-PRO FORMA PLANT ADDITIONS AND PLANT RECLASSIFICATIONS

21 **Q. Do you agree with Staff's adjustments to the pro forma plant additions and the**
22 **proposed adjustments to reclassify plant in service?**

23 A. Yes, I do.
24

25 ADJUSTMENT TO CIAC

1 **Q. Do you agree with Staff's adjustment to remove the effects of the amortization on**
2 **CIAC stemming from the Commission Ordered Adjustments ordered in Docket No.**
3 **94-0512?**

4 A. Yes, I do.

5
6 ADJUSTMENT TO ACCUMULATED DEFERRED INCOME TAXES

7 **Q. Do you agree with Staff's adjustments to Accumulated Deferred Income Taxes as**
8 **result of rate base adjustments that you have indicate will not be opposed by the**
9 **Companies?**

10 A. Yes, I do.

11
12 RECOMMENDATIONS CONCERNING PLANT RETIREMENTS AND COMMISSION
13 ORDERED ADJUSTMENTS FROM PRIOR CASES

14 **Q. Do the Companies opposes Staff's recommendations regarding plant retirements and**
15 **booking prior commission ordered adjustments?**

16 A. No. The Companies will file the actual journal entries for all recommended retirements
17 and Commission-ordered adjustments within 60 days of the final orders. The Companies
18 will further provide a report to the Manager of Accounting of the Commission identifying
19 the Companies' process associated with retirements. The Companies will ensure that the
20 annual reports show the retirements appropriately going forward.

21 **Q. Please respond to Staff's question about how the Companies are in compliance with**
22 **USOA Accounting Instruction 20A?**

1 A. First, Accounting Instruction 20A covers overhead costs for items such as general office
2 salaries. Based on my interpretation of the USOA, I believe that Accounting Instruction
3 No. 19 Utility Plant – Components of Construction Costs, (2) Labor is more appropriate.
4 Accounting Instruction 19 (2) refers to employees' construction work or capitalized labor
5 costs.

6 Further, Staff Witness Ebrey points to the installation of 73 meters at a unit cost of \$50. In
7 particular, Ms. Ebrey states: "...or the labor incurred to install the new meters was being
8 identified with the cost of the meters." In general, the Companies' threshold of creating a
9 capital project is \$50,000. For projects above that threshold the specific capitalized time
10 and interest during construction are separately tracked. To separately track the capitalized
11 time for multiple smaller capital additions such as the meter installation projects in Ms.
12 Ebrey's example would be unnecessarily burdensome for the Companies. The following
13 illustration demonstrates how burdensome the tracking of capitalized time for many small
14 additions such as the 73 meter installations, upon which Ms. Ebrey focused. The 73 meters
15 were installed for 73 individual houses in a particular area. Under Ms Ebrey's
16 recommendation, each meter for each separate house would need a project assigned to it.
17 The installation for each meter takes less than one day. As soon as each individual meter is
18 installed, the project would need to be closed. The administrative work that would go with
19 opening and closing of each project on a daily basis is unreasonable and burdensome. In
20 addition, the tracking and recording of cap time for each individual meter installation is an
21 extremely difficult task for the operator who would be installing the meters. The operator
22 will spend additional time to track and record his time for these small yet numerous
23 projects.

1 The instance of one retirement that Ms. Ebrey points out on page 21 where cap time and
2 IDC were subtracted from the cost of an asset was an inadvertent error by one of the
3 Company's accounting personnel. The Company's retirement policy is and always has
4 been to include the complete cost of the project including capitalized time and interest
5 during construction when booking a retirement journal entry. Retirements typically do not
6 have any impact on rate base since the debit to accumulated depreciation equals the credit
7 to plant. Since there is zero rate base effect when booking a general retirement, the need to
8 track individual capitalized time for small voluminous projects is mitigated

9 **Q. Do you agree with Staff proposed depreciation rates?**

10 A. Yes, I do, and they have been reflected in my rebuttal exhibits.
11

12 UNACCOUNTED-FOR WATER (Killarney Only)

13 **Q. Do you oppose Staff's adjustment to decrease Killarney's maintenance expenses due**
14 **to unaccounted-for water?**

15 A. No, I do not.
16

17 PUBLIC UTILITY TAX

18 **Q. Do you agree with Staff's adjustment to remove Add-On Taxes from the Companies'**
19 **income statements?**

20 A. Yes, I do.

21 **Q. Do you agree with Staff's proposed tariff language related to the "Annual Gross**
22 **Revenue Tax Recovery Charge?"**

23 A. Yes, I do.

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RATE CASE EXPENSE

Q. Do you agree with Staff’s adjustment to remove certain rate case expense items?

A. No. I do not agree with the adjustment to completely remove travel expense. One or more Company witness and support person will be required to travel to the evidentiary hearing and to various customer hearings. The Companies are proposing to include \$200 in travel costs to be distributed to each company. In addition, I have updated rate case expense based on the Third Supplemental Rate Case Expense Data Request DLH 2.05 filed on November 11, 2011. This adjustment is reflected in my schedules.

Q. Do you oppose the 5-year amortization period?

A. The Companies do not oppose Staff’s five-year amortization period.

Q. Have the Companies updated their rate case expenses in your rebuttal exhibits?

A. Yes, I have updated the actual rate case expenses through October 31, 2011 plus an estimate of the amount to bring the case to conclusion. This estimate does not include potential rehearing and appeal costs, which cannot be predicted with certainty at this time. Supporting documentation of the additional rate case expense have been provided to Staff in supplemental responses to Staff data requests, and we will continue to supplement those responses as the cases progress. This supporting documentation is included in Exhibit 3.3 for each Company.

Q. Do you agree with the Attorney General’s argument that the Companies are over-recovering on labor expense by including capitalized time charged to each rate case in rate case expense?

1 A. No. I do not agree with this claim. Each Company is seeking recovery of actual costs
2 incurred and an estimate to bring each case to conclusion. The capitalized salary costs are
3 subtracted from the salary amounts allocated to the Companies pursuant to the allocation
4 methodology approved in Docket 08-0335, and the Attorney General is subtracting all cap
5 time charged to the six rate cases. If the AG is so inclined to remove capitalized time
6 related to rate cases then they would need to make an adjustment to remove the capitalized
7 time thus increasing operation and maintenance expense. However, no such adjustment
8 was proposed.

9 The Companies are not double-counting the WSC capitalized time incurred for the rate
10 cases. The Attorney General incorrectly states that an employee's cost for work on the rate
11 case are being recovered as test year expenses allocated to the Companies. This
12 assumption is not the case. Take, for example, an employee with total annual salary,
13 payroll taxes and benefits of \$50,000 who spends half her time working on the rate cases
14 and other capitalizable projects, which can be directly assigned to a certain company and
15 the other half working on matters that are not directly assignable to a particular utility. On
16 the Company's books, \$25,000 would be charged to deferred rate case expense or operating
17 expense charged to plant, and only the remaining \$25,000 would have been allocated to test
18 year expenses. The net effect of his adjustment is to deny recovery of a substantial portion
19 of the rate case expenses actually incurred by the Companies.

20 The Companies reduced test year salaries, benefits and payroll taxes for capitalized salaries
21 charged to plant and capitalized salaries charged to deferred rate case during the test year.
22 Below is a series of journal entries depicting the above referenced example of an employee

who is paid \$50,000, which for this example includes, salary, benefits and taxes and the reduction to employee costs for capitalized time and the corresponding explanation:

<u>Entry</u>	<u>Description</u>	<u>Debit</u>	<u>Credit</u>
(1)	Salary expense	50,000	
	Accounts payable		50,000
(2)	UPIS	10,000	
	Operating Exp. Charged to Plant		10,000
(3)	Deferred rate case exp	15,000	
	Operating Exp. Deferred - Rate Case		15,000

Entry number 1 – Salary expense

This is a debit to salary expense and a credit to accounts payable. This entry generates \$50,000 of salary expense. Below is what the T account or trial balance would look like:

<u>Salary expense</u>		<u>Accounts payable</u>	
Debit	Credit	Debit	Credit
50,000			50,000

Entry number 2 – Time spent on a capital project, other than a rate case

This is a debit to a plant account and a credit to operating expense charged to plant. This credit entry reduces the expense by \$10,000, so the expense appearing on the Company's income statement would only be \$40,000. Below is what the T account or trial balance would look like:

<u>UPIS</u>		<u>Operating Exp. Charged to Capital Project</u>	
Debit	Credit	Debit	Credit

10,000		10,000

Entry number 3 – Time spent on a rate case

This is a debit to a deferred rate case and a credit to operating expense – deferred rate case.

This credit entry reduces the expense by \$15,000, so the expense appearing on the Company's income statement would only be \$25,000 (\$50,000 - \$10,000 - \$15,000).

Below is what the T account or trial balance would look like:

<u>Deferred rate case</u>		<u>Operating Exp.</u>	
<u>exp</u>		<u>Charged to Capital</u>	
Debit	Credit	Debit	Credit
15,000			10,000
			15,000

Q. Did the Companies' filings reduce salary expense consistent with the above example?

A. Yes. In addition, Staff used these reduced levels of expenses in their revenue requirements.

In the current rate case filings, the capitalized time charge to plant accounts are located on work paper [b-2] Salary Captive provided in response to Staff DR DLH 1. Work paper [b-2] includes the capitalized time charged to plant and capitalized time charged to deferred rate case for each employee for the entire test year period. Mr. Brosch states on page 23 of his testimony that "Yes, the asserted test year operating expenses for each case include a full year's annualized and allocated salary and benefits"; however, he fails to mention that

these expenses were reduced to reflect a full year's annualized capitalized time charged to capital project is also included in each filing.

Q. If the Commission would adopt this adjustment would the Companies fully recover all of their salary expense?

A. Absolutely not. With this adjustment the Companies would not fully recover its salary, benefits and payroll tax expense. Below is an example of how we should be recovering our employee costs:

	<u>Expenses</u>	
Gross Salary Expense	50,000	
Charged to Plant	(10,000)	Recovered via rate base
Charged to Deferred RC	(15,000)	Recovered via rate case expense
Net Salary Expense	25,000	

The test year would only include \$25,000 of salary expense, which would be recovered as an O&M expense. Typically, the rate case expense portion is amortized over some period of time.

Q. Why is it necessary to reduce salaries, benefits and payroll taxes in the test year for items charged to plant and rate case expense?

A. First I will address items charged to plant. WSC employees can and will capitalized their time, which is then converted to dollars, for utility plant in service items. This can include working on a capital project like a well or water treatment facility. This time or costs recorded to utility plant in service is recovered via rate base and is included in Staff's revenue requirement. WSC employees can and will capitalize costs for their time for rate case-related work because such costs are directly assignable. The Companies attempt to recover these costs via a ratemaking adjustment for amortization of rate case expenses.

Q. In the above example, which component of salary expense is Mr. Brosch eliminating?

1 A. Mr. Brosch, would be eliminating the \$15,000 in the above referenced example.

2 **Q. Has the Commission previously considered and addressed the issue raised by Mr.**
3 **Brosch??**

4 A. Yes, in Consolidated Docket Nos. 11-0059/0141/0142 the Company provided similar
5 explanatory testimony in response to questions posed by Staff. Ultimately, the Staff
6 concurred with the Companies and the Commission adopted Staff's schedules which
7 concluded that the Companies were not over recovering.

8 **Q. Have any other jurisdictions wherein WSC personnel operate ever disallowed WSC**
9 **employee costs for alleged over-recovery?**

10 A. No, I have been involved in rate cases in many jurisdictions in which WSC personnel
11 operate and no Staff has ever recommended to their respective Commission that WSC
12 personnel costs were being double recovered. It is not unusual for utilities to include their
13 own employees' labor costs in rate case expense.

14 **Q. Have all of the other jurisdictions wherein WSC personnel operate audited WSC's**
15 **books and records?**

16 A. Yes, they have.

17 **Q. If the Commission adopts Mr. Brosch's recommendation, will the Companies fully**
18 **recover its employee costs?**

19 A. Absolutely not.

20 **Q. If the Commission adopts the Companies' recommendation will the Companies over-**
21 **recover employee cost?**

22 A. Absolutely not.

1 **Q. If the Commission adopts the Companies' recommendation will the Companies fully**
2 **recover employee cost?**

3 A. The absolute dollar value of the costs would be recovered over time. However because of
4 the deferral of the recovery and the time value of money, the Companies will not recover
5 the full cost unless carrying costs on the unamortized balance were allowed. The
6 Companies are not seeking recovery of carrying costs in this case.

7 **Q. Has the Commission and the Staff concluded that internal costs related to a rate cases**
8 **shall be charged to each company?**

9 A. Yes, attached to the final order issued on April 22, 2009 in Docket No. 08-0335 is
10 Appendix A. This appendix is the Companies intercompany agreements. The agreement,
11 which was approved by this Commission, clearly state that salary and other expenses
12 incurred for a rate case should be directly charged to the Company.

13 **Q. Is it usual and customary for utilities with parent companies that operate in more**
14 **than one jurisdiction to include their own employees' labor costs within rate case**
15 **expense?**

16 A. Absolutely. It would be inappropriate for customers in Florida to pay for the internal labor
17 costs to prepare and litigate these Illinois cases. It also would be inappropriate for Illinois
18 customers to pay for labor costs to prepare and litigate a rate case in North Carolina. If the
19 Company's parent company was a single state platform and had one operating company
20 then I might agree that internal labor costs would be exclude from rate case expense
21 because these labor costs would have been included as a component of operation and
22 maintenance expense. However, that is not the case.

1 **Q. Have the Companies done anything to reduce rate case expense which ultimately**
2 **benefits the ratepayers?**

3 A. Yes, they have. Various steps have been taken in order to reduce the size of the rate
4 increase in this docket. The Company has not hired an equity consultant in order to
5 decrease rate case related costs. Further, the Company has changed the former legal
6 counsel in order to significantly decrease hourly legal fees. In addition, most data requests
7 are prepared, reviewed, and furnished internally in order to minimize the legal costs.
8 Finally, please refer to AG DR 1.28 for additional cost reduction incentives that have been
9 undertaken by Water Service Corporation.

10 **Q. Is Mr. Brosch correct when he states at page 24 of his testimony that this necessary**
11 **matching of labor cost distribution is not reflected in the Company's test year**
12 **expenses.**

13 A. No. His example compares apples and oranges. Rate case expense is a pro forma
14 adjustment that is not reflected in the test-year expenses. The \$140,000 he identifies as
15 recoverable rate case expense represents costs that were incurred or will be incurred after
16 the historical test year used in this case. In the post test-year periods when those costs are
17 actually paid, they are directly assigned to the Companies, and subtracted from the O &
18 M labor costs that are allocated to the other UI affiliates in the manner I have described.
19 In this way, any company having a test year when these costs are incurred (i.e., 2011)
20 will have allocated O&M expense that reflects the deduction of cap time that has been
21 directly charged to the Companies for these cases. On the other hand, the "less than
22 \$10,000 of such WSC capitalized time" he identifies represents the Companies' allocated
23 portion of the total cap time for all UI companies that was subtracted from test-year O &

1 M. During the test year ending September 2010, the total cap time was approximately
2 \$1.4 million. This figure includes the total labor costs spent on rate cases for other
3 companies during the test year as well as other capital projects. The Companies' share of
4 those expenses, based upon its ERCs was less than \$10,000. In other words, the O & M
5 labor costs included in the test year for the Companies includes no rate case expense for
6 any UI company. The cost of time spent on rate cases during the test year has been
7 totally deducted from O & M, leaving only labor costs associated with non-rate case
8 activities such as billing, accounting, personnel management, purchasing, information
9 technology services and other similar activities that cannot be directly assigned to a
10 specific company.

11
12 PRO FORMA SALARIES AND BENEFITS ADJUSTMENT

13 **Q. Do you agree with Staff's adjustment as it pertains to the WSC allocations of salaries**
14 **and benefits?**

15 A. Yes, I do.
16

17 UNCOLLECTIBLES EXPENSE ADJUSTMENT (Harbor Ridge only)

18 **Q. Do you oppose Staff's adjustment to normalize uncollectibles expense for Harbor Ridge?**

19 A. No.
20

21 CONSUMER PRICE INDEX ("CPI")

22 **Q. Do you agree with Staff's and the Attorney General's adjustment to remove the CPI**
23 **adjustments?**

1 A. For the purposes of resolving the current rate cases, the Companies will not oppose the
2 removal of CPI for the six cases.
3

4 WATER AND SEWER DEPRECIATION RATES

5 **Q. Do you agree with Staff Witness Johnson's water and sewer depreciation rates?**

6 A. Yes, I do.
7

8 RATE DESIGN

9 **Q. Do you agree with Staff's recommendations regarding working with Staff to develop a**
10 **cost of service study ("COSS")?**

11 A. Yes, in part, I agree. Although, I agree that the Companies should work with Staff to
12 develop a COSS provided that the COSS that Staff is proposing is similar to the COSS that
13 was presented in the Galena Territory Utilities Rate Case in Docket No. 10-0280, I do not
14 agree that it should be six months prior to the Companies' next rate case. This time frame is
15 unrealistic as a decision to file a rate case may occur less than six months prior to filing a
16 rate case. For example, some decisions to file certain rate cases might not be made until
17 about 30-90 days prior to the filing date. It would be impossible to talk specifics about
18 those particular rate cases six months in advance.

19 **Q. Do you agree with Staff's proposed rate design for the six Companies?**

20 A. Yes, I do.
21

22 MISCELLANEOUS

1 **Q. Do you agree with Staff’s recommendation for the miscellaneous tariff changes for all**
2 **six Companies?**

3 A. Yes, I do.

4 **Q. Do you agree with Staff’s recommendation related to monthly billing cycles for**
5 **Charmar, Cherry Hill, and Harbor Ridge?**

6 A. Yes, I do.

7 **Q. Do you agree with Staff’s recommendation to file updated bill forms for all six**
8 **Companies?**

9 A. Yes, I do. The updated bill forms are included as Exhibit 3.2.

10 **Q. Do you agree with Staff’s recommendation to update the tariffs for the six Companies**
11 **with the revised rules, regulations, and conditions?**

12 A. Yes, I do.

13 **Q. Do you agree with Staff’s recommendation to update the tariffs of the six Companies**
14 **to be consistent?**

15 A. Yes, I do.

16 **Q. Do you agree with Staff’s recommendation to remove Rider 1 from the tariffs in**
17 **Charmar, Cherry Hill, Clarendon, Killarney, and Ferson Creek?**

18 A. Yes, I do.

19 **Q. Do you agree with Staff’s recommendation to add “Downers Grove Township” to the**
20 **Clarendon tariffs?**

21 A. Yes, I do.

22 **Q. Do you agree with Staff’s recommendation to change “Applies to the following**
23 **Territories” to state “Lake Killarney, Subdivision, Algonquin Township, McHenry**

1 **County, Illinois, on the Original title sheet of the Company's proposed Rules for**
2 **Killarney?**

3 A. Yes, I do.

4 **Q. What Return on Equity ("ROE") has been used to calculate the revenue requirements**
5 **shown in your rebuttal exhibits?**

6 A. I have used Staff's recommended ROE.

7 **Q. Why have the Companies used Staff's ROE in these dockets?**

8 A. In most other jurisdictions wherein Utilities, Inc.'s owns sewer and water companies the
9 operating companies will either engage a cost of equity expert or use the formulaic
10 approach, if applicable. Since I am unaware of a formulaic approach available to
11 determine cost of equity in Illinois the Company's only other alternative is to engage a cost
12 of equity expert, which can cost in excess of \$30,000 if the witness needs to provide direct
13 and rebuttal testimony, respond to data requests, and travel to a hearing or adopt Staff's
14 proposal. Ultimately these costs would be passed on to ratepayers as rate case expense,
15 which Staff is proposing be amortized over five years.

16 **Q. What other steps have the Companies taken to reduce rate case expense?**

17 A. Approximately five years ago Utilities, Inc. changed law firms to a mid-tier law firm
18 named Howard & Howard ("HH"). HH's lawyer's 2011 hourly rates are 14% lower than
19 the rates UI was paying a national law firm in 2007. When considering the fact that the
20 national law firm continued to increase hourly rates for the past four years the lower rates
21 represent substantial saving to ratepayers.

22 **Q. Have you included updated tariff sheets reflecting the Companies' Rebuttal positions?**

1 A. Yes, the updated tariff sheets reflecting the Companies' Rebuttal positions are attached as
2 Exhibit 3.2.

3 **Q. Have you made all of the prior adjustments that you discussed?**

4 A. Yes, all of the adjustments discussed above are contained in Exhibit No. 3.0, Schedule 3.1
5 for each Company.

6 **Q. Have you included new income statements, rate base schedules, rate schedules and**
7 **supporting work papers?**

8 A. Yes, I have. The adjusted customer rates after incorporating the Staff's adjustments that I
9 have discussed are contained in Exhibit No. 3.0, Schedule 3.1 for each Company. I used
10 Staff's work papers and exhibits, which were provided during the course of discovery.

11 **Q. Please respond to the Attorney General's proposal to phase in rates?**

12 A. The current rates have not been increased since 1984 for Ferson Creek, 1995 for Killarney
13 and Harbor Ridge, 2004 for Cherry Hill and Charmar, and 1998 for Clarendon. The
14 Companies' rebuttal and Staff's direct testimony show that the new rates are commensurate
15 with the increases in operating expenses and plant investments that have occurred over the
16 time frames that have elapsed since the test years for the last rate cases, during which time
17 the Companies have forgone any rate relief. The magnitude of the rate increases is not
18 disproportionate to the amounts that would be expected after decades of inflation and
19 increasing regulatory requirements. In order to contain costs, the Companies limit
20 resources they can devote to filing rate cases. To file more often and thus decrease the
21 incremental percentage rate increase would require additional personnel and outside
22 assistance of costly professionals, the cost of which would be borne by customers.

In addition, if the Attorney General's gradualism approach is adopted by the Commission, the Companies' costs will not be fully recovered. By using the Attorney General's rates phase in proposal as specifically shown on AG Exhibit MLB – 1.4, the Companies' return on equity does not come close to the reasonable return on investment that was proposed by Staff Witness Freetly (ROE of 9.43%). Below is a table that shows what the Return on Equity after Phase I would be for each Company if the Commission would adapt the Attorney General's rates phased in approach:

	ROE after Phase I	ROE per Staff Witness Freetly
Ferson Creek	-1.40%	9.43%
Harbor Ridge	-0.28%	9.43%
Clarendon	-10.51%	9.43%
Cherry Hill	-7.58%	9.43%
Charmar	-25.52%	9.43%
Killarney	-12.77%	9.43%

It is obvious that with Mr. Brosch's rates phase in approach, the Companies will not be able to earn the recommended fair return on equity. In fact, all of the Companies would be cash flow negative, and the rates would fail to recover the costs of providing service, including the reasonable cost of capital. Dr. Phillips elaborates in *The Regulation of Public Utilities* (1993 Ed.) at 343 that there are four critical questions underlying a phase-in proposal, and they are:

- 1) Does the plan contribute adequately to the cash flow position of the utility?

1 2) What is the added risk to the firm from deferring the recovering of invested
2 capital?

3 3) Are lower rates to current ratepayers favored over high rates to future ratepayers?

4 4) Is the plan in conformity with FASB Statement No. 71?

5 The Attorney General has not prepared or provided any analysis regarding the four issues
6 raised by Dr. Phillips. However, it is clear that negative cash flow would not adequately
7 address the Companies cash flow concerns, and the Attorney General's proposed phase-in
8 rates should not be implemented.

9 **Q. Do you have any comments as it pertains to the Attorney General's proposed phase in**
10 **rates and the resulting carrying costs?**

11 A. Yes, the AG's phase-in rates shown on AG Exhibit MLB1.4, which are for demonstrative
12 purposes only, are missing three significant components and should be rejected as it is only
13 a partial analysis and does not tell the complete story necessary for the Companies to
14 achieve their overall rate of return.

15 **Q. What are the three significant components that the AG failed to include in their**
16 **analysis?**

17 A. First, the AG's phase-in rates shown on AG Exhibit MLB 1.4, which are for demonstrative
18 purposes only do not include a calculation of carrying cost, which the AG asserts the
19 Company may be entitled to accrue. Second, the AG's analysis never allows the Company
20 to recover the residual deferred revenue shown in AG Exhibit MLB-1.4, Lines 7, 14, 21 &
21 28. The AG's use of the word deferred assumes collection sometime in the future.
22 However, this is absent from AG Exhibit MLB 1.4. Lastly, the AG fails to show rates that
23 make the utility whole for the residual deferred revenues and carrying cost.

1 **Q. Have you provided such an analysis?**

2 A. Yes, I have. I have used the rates and phase in percentages depicted in AG Exhibit MLB-
3 1.4, which I do not agree for multiple reasons.

4 **Q. Why do you disagree with the rates shown in AG Exhibit MLB-1.4?**

5 A. First and foremost is that the AG's expert witness has done no work to determine what the
6 rates should be or advise the Commission what the appropriate rates should be. The AG's
7 witness simply states that the rates shown on AG Exhibit MLB-1.4 are assumed values for
8 illustration purposes only. In fact, the AG's witness suggests that the Commission should
9 calculate the rates potentially doing his work for him.

10 **Q. Please continue to describe your analysis?**

11 A. I used the AG's assumed rates, which were shown for illustrative purposes only, so the
12 parties could have comparable rates. First, I started determining the monthly residual
13 revenue deferred per AG Exhibit MLB-1.4 and converted that to a annualized number.
14 This was a necessary step in order to properly calculate carrying cost. Second, I
15 determined the term until the residual revenue would be collected and calculated carrying
16 costs using Staff overall cost of capital of 7.98%. Third, I added the carrying cost to the
17 residual revenue deferred to determine the cumulative residual revenue deferred including
18 carrying costs. Lastly, I converted the cumulative residual revenue deferred including
19 carrying costs to a monthly revenue requirement. I have prepared a schedule for seven of
20 the eight scenarios depicted on AG Exhibit MLB-1.4. I excluded Harbor Ridge sewer
21 because according to Mr. Brosch's assumed rates, which are for illustrative purposes only,
22 a phase in plan is not necessary.

23

1 **Q. Do you have any additional comments as it pertains to the Attorney General's**
2 **proposed phase in rates and the resulting carrying costs?**

3 A. I do not believe the Commission should implement phase-in rates. In my opinion, any
4 phase-in rate that does not include full recovery of the residual deferred revenue and
5 carry costs is an unconstitutional taking and therefore should be rejected. If the
6 Commission decides that phase-in rates are appropriate then the carrying costs should be
7 tied to the Company's overall cost of capital, which is 7.98%. The overall cost of capital
8 can be found in ICC Staff Exhibit 3.0, Schedule 3.1.

9
10 **Q. Please respond to the Attorney General's proposal for UI to explain the increase in**
11 **costs since last rate case for each of the six Companies.**

12 A. Staff has performed an extensive investigation of the Companies' operations, including a
13 comprehensive review of the Companies' records and received responses to numerous
14 detailed data requests. The Attorney General has received all of these responses. The
15 Attorney General's claim that the increases are unsupported is meritless. In addition, the
16 Attorney General has not specified that any cost incurred by the Companies that is
17 unreasonable because of inefficiency or bad faith. In addition, the Attorney General states
18 on page 7 of his testimony that the Companies did not explain why their proposed rate
19 changes are so large, which is incorrect. The main reasons were incorporated in data
20 responses to AG DR 2.3. In addition, the filings for all six Companies accompanied by the
21 continuing property records which show all plant additions since last rate case were
22 available for the Attorney General to review and direct testimony which describe some
23 major plant additions. Finally, I will illustrate how the consumer price index alone has

increased significantly since last rate case for Ferson Creek as an example. Ferson Creek has not filed a rate case since 1984 or 27 years ago. The CPI increase since that time was 230% which is an average and does not take into consideration specific costs increases such as chemicals, transportation, insurance, etc. Based on Table 1 of AG Ex. 1.0, the Ferson Creek water revenue increase is 100% and the sewer revenue increase is 91%. Both of the increases that the Company is requesting are less than the CPI increase since last rate case.

Q. Please discuss the Companies' increases in O&M and rate base since the last respective rate cases.

A. Certainly. Below is a chart with the increase in O&M and rate base figures since each each Company's last rate case.

	CPI increase since last rate case	% Increase Requested per table 2 AG EX 1.0	O&M % increase since last rate case [2]	Rate Base Increase Since Last Rate Case	Rate Base % Increase Since Last Rate Case
Charmar W	56%	283%	35%	\$ 236,952	248%
Cherry Hill W	61%	128%	-16%	\$ 314,991	166%
Clarendon W	93%	156%	-10%	\$ 321,460	101%
Killarney WW	93%	249%	5%	\$ 498,680	507%
[1] Ferson Creek W	230%	96%	208%	\$ 853,893	207%
[1] Harbor Ridge W	106%	80%	39%	\$ 381,431	284%

[1] O&M based on water and wastewater combined.
Increase for combined is the average of water and wastewater.

[2] The O&M figures do not include rate case expense, depreciation, and taxes.

1 The CPI increase alone represents a significant portion of the O&M increase in most rate
2 cases. In addition to the CPI increase and certain increases in O&M, the rate base for each
3 company has increased significantly since rate base was last established. Bruce Haas has
4 fully explained in his direct testimony what the major projects contributing to the rate base
5 increase were. Bruce Haas will further explain in his rebuttal testimony why it was
6 necessary to incur the plant costs in order to meet our obligation. He will further expand in
7 his rebuttal on certain significant general ledger additions and why they were necessary to
8 serve the public.

9 **Q. Were the Attorney General and the ICC Staff given the opportunity to examine the**
10 **rate base increases, related projects and general ledger additions?**

11 A. Yes, they did. The continuing property records that included all plant increases were
12 thoroughly examined by the ICC Staff and provided to the Attorney General.

13 **Q. Do you agree with the Attorney General's proposal to remove the pro forma projects**
14 **for Cherry Hill, Killarney, and Harbor Ridge?**

15 A. No, I do not. It is possible that Mr. Brosch is unfamiliar with the Commission rules that
16 allow recovery of pro forma adjustments to the test year for known and measurable
17 changes expected to occur within 12 months from the filing of the rates. The projects
18 included in the respective cases are scheduled to be completed within 12 months from the
19 time of filing.

20 **Q. Do you agree with the Attorney General's proposal to remove cash working capital**
21 **from the Companies' rate base?**

22 A. No, I do not. Lead-lag studies are expensive and any cost related to a lead-lag study will be
23 passed through the customers.

1 **Q. Have the Companies considered availing themselves of the simplified rate**
2 **procedures for small companies under 83 Ill.Admin.Code 255.20(g)?**
3

4 A: Yes. However, while the simplified procedures may be advantageous for small stand-
5 alone companies, they would not necessarily be cost-effective for an organization like
6 Utilities, Inc. The Companies and their affiliate WSC are wholly-owned subsidiaries of
7 Utilities, Inc., which directly or through operating subsidiaries provides water and
8 wastewater services to more than 300,000 customers in 15 states. WSC maintains an
9 organization with officers and employees who are familiar with the development,
10 business and property of the Companies, and who are experienced in the conduct,
11 management, financing, construction, accounting and operation of water and sewer
12 properties. The Companies rely on WSC, with its experienced staff of specialists in all
13 phases of water and waste water public utility business, for essentially all operational
14 services to ensure that Petitioners receive the necessary services at the most economical
15 cost, consistent with the Petitioners providing reliable and safe service to the public. In
16 order to achieve the economies of scale available to the larger organization it is essential
17 the organization be able to plan and coordinate its regulatory efforts in a manner that
18 allows it the minimize costs of the shared personnel.

19
20 It should be noted that the simplified procedures do not apply to a utility with more than
21 \$300,000 of annual operating revenues. Several of the Utilities, Inc. utilities operating in
22 Illinois exceed this threshold, and therefore are not eligible for the simplified procedures.
23 In light of the fact the larger affiliates cannot avoid traditional rate cases and they share
24 many expenses with the smaller utilities, it can be more efficient for Utilities, Inc.

1 personnel to also work on the preparation of the smaller utility case and file the rates
2 concurrently with the larger cases.
3

4 Under the simplified rate procedure, the utility must still submit to a Staff review,
5 examination and evaluation of its books, records and operations. The Companies would
6 need to provide detailed information to support increased rates. All of the information
7 that Staff has requested in a traditional rate case would undoubtedly be required to be
8 provided to support the increase under the simplified procedure. The filing requirements
9 of Part 285 do not apply to utilities with less than 35,000 customers, and hence the
10 simplified procedures do not diminish the quantity and quality of information that the
11 small company must provide to support its revenue request. Consequently, the simplified
12 procedure would require the same extensive planning and dedication of personnel,
13 including the review and advice of counsel, that would be necessary for a traditional rate
14 case.
15

16 Unlike a standard rate case, there is no time limit for the Staff or the Commission to act
17 on the small utility's request for an increase, and there is no procedure for the resolution
18 of issues that may arise in the course of the review. If after engaging in several months
19 of review, Staff and the utility were unable to reach an agreement on the utility's revenue
20 requirement, the utility would find itself required to initiate a rate case, and the test year
21 data may have changed significantly. The uncertainty and delay associated with the
22 simplified procedure would make it exceedingly difficult for Utilities, Inc. to coordinate
23 its rate case efforts for the numerous companies it operates in 15 different states.

1 Moreover, even if the utility and Staff agreed on the proposed rates, the rule requires
2 notice of the proposed rates be provided to customers together with information about the
3 manner in which customers may obtain information or express views on the increase.
4 After being notified of the proposed increase, the customers may urge the Commission to
5 suspend the tariffs, and even if not suspended, the customers may petition the
6 Commission for an investigation, so any potential savings are likely to be illusory. In the
7 future, the companies should be able to cost-effectively adjust its rates if necessary on a
8 more frequent basis as a result of its recent implementation of new accounting and
9 financial software systems.

10
11 **Q. Does this conclude your rebuttal testimony?**

12 A. Yes, it does.